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**NAVAL WAR COLLEGE
Newport, R.I.**

NAFTA: the Mexican Economy, and Undocumented Migration

by

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A paper submitted to the Faculty of the Naval War College in partial satisfaction of the requirements of the Department of Joint Military Operations.

The contents of this paper reflect my own personal views and are not necessarily endorsed by the Naval War College or the Department of the Navy.

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28 October 2011

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Abstract

NAFTA, The Mexican Economy, and Undocumented Migration

The North American Free Trade Agreement is variously blamed for undocumented migration from Mexico and credited with reducing it. This paper seeks to distinguish free trade's influence upon the Mexican economy from other factors and argues that where it affected employment it also affected prosperity. In this way it either improved or worsened the conditions driving Mexicans to migrate to the United States. The paper concludes with an assessment of NAFTA's effect on undocumented migration, considers its future potential, and recommends measures to increase the chances of positive results.

Introduction

The North American Free Trade Agreement (NAFTA) went into effect in 1994, but not without considerable controversy in the United States. A free trade agreement was already in place between the United States and Canada, so it was the admission of Mexico to the trading block which garnered the most attention among various American constituencies. Many expected NAFTA to have a significant, positive impact on trade between the United States and Mexico. American manufacturing and agricultural interests anticipated greater access to Mexican markets and low cost labor. On the other hand, domestic labor interests feared jobs would be exported as industries gained access to the cheaper work force south of the border. One of NAFTA's key selling points with Congress was that it would improve the Mexican economy and thereby erode the conditions driving undocumented migration to the United States.

The main cause of undocumented migration from Mexico into the United States is economic in nature.¹ Therefore, it was logical to expect that, by boosting the Mexican economy, free trade would reduce the migrant flow. On that basis, the trade agreement's influence on migration can be determined by examining its effects on the Mexican economy. Specifically, to the extent that it reduced unemployment it also reduced poverty and thereby alleviated the economic pressures driving portions of the Mexican population to emigrate.²

During the last seventeen years, the Mexican economy responded to many influences. While these factors render NAFTA's impact difficult to isolate with precision, it is possible to determine whether the agreement contributed to or detracted from broad trends and

¹ Jeffrey S. Passel, "Unauthorized Migrants: Numbers and Characteristics," (Washington DC: Pew Research Center, June 14, 2005).

² Stephen W. Hartman, "NAFTA, the Controversy," *The International Trade Journal* 25, no. 1, 2011.

thereby generally improved or exacerbated economic conditions. An examination of the manufacturing and agricultural sectors allows conclusions regarding the trade agreement's effects on employment, which in turn drove changes in poverty rates and thereby influenced pressures to emigrate. Though NAFTA produced mixed impacts on the Mexican economy, it nevertheless contributed to the amelioration of unemployment and poverty in certain respects. In this way, it affected the conditions driving undocumented migration to the United States, and demonstrated the potential to do so more substantially.

Counter-arguments

NAFTA's net impact on the Mexican economy is the subject of controversy which falls broadly into two camps: those who believe the trade agreement proved beneficial over all, and those who believe it had a net negative effect. Compelling arguments have been made in favor of both perspectives. This paper supports the view that NAFTA had a positive effect on the Mexican economy and in important respects demonstrated the potential to improve that performance, particularly with modifications based on lessons learned in the past seventeen years.

A substantial body of writing and research argues that NAFTA caused undocumented migration from Mexico to the United States to skyrocket during its first ten years. At face value, immigration data support this view. However, while NAFTA was indeed one of a number of factors influencing migration during this period, others were far more significant at times. The trade agreement may have actually cushioned the Mexican economy from the impact of other events and mitigated effects on migration.³

³ M. Angeles Villarreal, *NAFTA and the Mexican Economy*, (Washington DC: Congressional Research Service, June 3, 2010) 4.

Between 2005 and 2010, the flow of undocumented migrants north across the border declined significantly. Some experts attribute the steep downward trend to some combination of ramped up border security, tougher law enforcement within the United States, hardening attitudes against migrants, and the struggling American economy. All of these factors certainly influenced the flow of undocumented migration, but so did NAFTA.

Macro-Economic Performance

An in depth assessment of the Mexican economy during NAFTA is beyond the scope of this paper, but this section seeks to characterize the trade agreement's general positive or negative effects by examining broad macro-economic trends against a backdrop of key events. Attributing these trends to NAFTA specifically risks mistaking correlation with causation because many other factors contributed. Domestic and international financial crises (especially American) played significant roles, as did Mexican policies, and to a lesser extent trade with other countries. Nevertheless it is possible to determine with reasonable confidence whether free trade contributed to or detracted from those macro-economic trends.

Not surprisingly for a free trade agreement, strong increases in trade constituted some of NAFTA's clearest and most positive results. Although Mexico signed an increasing number of free trade agreements with other nations (including Canada under NAFTA), over 80% of Mexican exports went to the United States, making her overwhelmingly Mexico's most important trading partner.⁴ For this reason, only the interplay between the U.S. and Mexican economies in the context of NAFTA is considered in this paper.

In the ten years prior to the trade agreement, Mexican exports to the United States grew from \$19 billion to approximately \$50 billion while imports rose from \$14 billion to

⁴ EconomyWatch, *Mexico Export, Import & Trade*, 24 March 2010, http://www.economywatch.com/world_economy/mexico/export-import.html.

\$50 billion. By 2010, Mexican exports to the United States totaled nearly \$240 billion, and imports reached \$154 billion. While trade between the two nations was on the rise prior to 1994, NAFTA accelerated the trend by lowering tariffs and other remaining barriers to trade. This afforded Mexican exports privileged access to North American markets and trade goods, and rendered Mexico more attractive to investment by foreign companies. Between 2000 and 2010, Foreign Direct Investment (FDI) from the United States alone exceeded \$123 billion.⁵ Trade clearly played a large role in Mexico's economic performance and contributed significantly to Gross Domestic Product (GDP) growth. From \$421 billion in 1994,⁶ GDP rose to \$1.57 trillion in 2010,⁷ more than tripling in 17 years. A World Bank study estimated that NAFTA boosted exports and trade by 25 percent and 40 percent, respectively.⁸

Increases in trade, FDI, and GDP under NAFTA are impressive and represent clear benefits to the Mexican economy. Determining the corresponding effect on employment, poverty, and migration is problematic, however, because trends in these areas were influenced by other significant factors. Between 2000 and 2008, GDP (PPP) rose from \$10,561 to \$14,200, poverty declined substantially from 54 percent to 44.5 percent,⁹ and undocumented migration to the United States fell precipitously by some 70 percent.¹⁰ Unemployment increased during the same period,¹¹ however, apparently against the grain of

⁵ U.S. Embassy, *Fact Sheet: U.S.-Mexico Foreign Direct Investment*, Mexico City, 2011.

⁶ World Bank, last modified October 21, 2011, <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>.

⁷ IndexMundi, last modified October 21, 2011. <http://www.indexmundi.com/g/g.aspx?v=65&c=mx&l=en>.

⁸ Daniel Lederman et al, *Lessons From NAFTA for Latin America and the Caribbean Countries*, The World Bank, December 2003, v.

⁹ Villareal, 5. GeoMexico, "Is poverty in Mexico on the rise?" <http://www.geo-mexico.com/?p=5075>. (cites a 2010 CONEVAL report). OECD (2010), "Country statistical profile: Mexico", *Country statistical profiles: Key tables from OECD*.

¹⁰ Jeffrey S. Passel & D'Vera Cohn, *U.S. Unauthorized Immigration Flows Are Down Sharply Since Mid-Decade*, Pew Hispanic Center, <http://pewhispanic.org/files/reports/126.pdf>.

¹¹ IndexMundi.

GDP, poverty, and migration trends. How free trade interacted with these factors remains difficult to discern, at least at the macro level. NAFTA nevertheless exerted a positive influence on the Mexican economy in important respects. Therefore, it is likely the trade agreement reduced the economic pressures upon Mexicans to migrate, but by how much is unclear. Manufacturing and agricultural performance under NAFTA better supports conclusions about effects on unemployment because free trade's impacts are easier to distinguish in these sectors.

Employment

Like macro-economic developments, employment trends in Mexico since 1994 responded to a variety of influences besides free trade. Mexican policies, the peso crisis of 1995, the U.S. recession following 9/11, and the global recession in 2008 all contributed, thereby complicating the determination of cause and effect. The service sector accounts for nearly two thirds of GDP, but because services employment was not susceptible to the influences of free trade it will not be considered in this paper.¹² NAFTA substantially affected Mexican formal employment in the Mexican manufacturing and agricultural sectors, however. Precise numbers of jobs gained or lost remain elusive, but it is possible to determine whether the agreement had a positive or negative net effect.

Official unemployment rates in Mexico remained low throughout the 1990s and 2000s. The most significant factor affecting employment between 1994 and 2000 appears to have been the peso crisis in 1995, which contributed significantly to a doubling of the unemployment rate. Both manufacturing and agricultural employment growth slowed considerably. The economy continued to add jobs throughout this period, but more than 50

¹² Sandra Polanski, "Mexican Employment, Productivity, and Income a Decade After NAFTA," Carnegie Endowment for International Peace, <http://carnegieendowment.org/pdf/files/canadasenatebrief.pdf>

percent of the work force was employed informally, such as in agricultural or construction day labor, without benefits or social security, and usually for very low pay.¹³ Partly thanks to free trade's effects on the manufacturing export industries, unemployment fell to less than five percent by 1998. Significantly, however, the informal employment rate remained above 50 percent.¹⁴ From 2000 to 2007, coinciding with strong U.S. economic performance, Mexico's unemployment remained below four percent.¹⁵ By 2007, informal employment fell to 27 percent and remained relatively steady through 2010.¹⁶ NAFTA can be credited with contributing to this substantial decline in informal employment because free trade led to modest but significant job creation in the formal sector.

Free trade and FDI did contribute to the creation of jobs in the manufacturing sector, but the overall numbers disappointed many. Although foreign direct investment and trade in manufactured goods increased dramatically, only 500,000-600,000 formal jobs were added in the sector by 2006.¹⁷ Four main factors affected growth in manufacturing employment: productivity, *maquiladora* industries, financial crises, and competition (primarily from China).¹⁸ Of these, growth in productivity and the nature of the *maquiladora* industry are attributable to the effects of free trade. Foreign direct investment and exposure to competition drove dramatic increases in productivity, thereby suppressing job growth. Much of FDI flowed to the *maquiladora* industry, which primarily imported parts for assembly and export, limiting job-creation in parts-supplying industries.¹⁹ While the 1995 peso crisis

¹³ Gary Martin, "Employment and Unemployment in Mexico," Monthly Labor Review, November 2000

¹⁴ Ibid.

¹⁵ IndexMundi.

¹⁶ Banco de Mexico Annual Report 2010.

¹⁷ Eduardo Zapeda et al, "Lessons from Mexico Under NAFTA," Carnegie Endowment for International Peace: Policy Outlook, December 2009, 10.

¹⁸ The *maquiladora* industries are primarily foreign-owned factories assembling products from imported parts for export to the United States. Most are located in Northern Mexico.

¹⁹ Ibid, 4.

boosted exports, the U.S. recession following September 11th, 2001 and the global recession in 2008 both reduced demand for exports. Although NAFTA did not cause the recessions it rendered the Mexican economy more vulnerable to downturns in the United States.

Consequently, the trade agreement probably contributed tangentially to rising unemployment. Between 2001 and 2003, the American recession triggered a decline in manufacturing employment, both in *maquiladora* and non-*maquiladora* sectors. Similarly, manufacturing exports fell from more than \$230 billion in 2008 to less than \$190 billion in 2009.²⁰ The rise of China also proved a major factor in depressing Mexican manufacturing employment. Since 2001, China's share of the U.S. import market increased steadily at the expense of Mexico's.

In 2010, experts reported encouraging signs of recovery and renewed growth. Samuel Freije Rodriguez, an economist with the World Bank, noted a trend of rising wages in Mexico together with a flattening of the unemployment rate and a reduction in informal employment.²¹ Despite rising levels of violence in Northern Mexico, Bob Cook, president of the El Paso Regional Economic Development Corporation, reported the creation of more than 10,000 jobs in Juarez during the first half of 2011 alone.²² In the first years of the 21st Century, China secured a rapidly increasing share of the U.S. imports. Mexican wages were 300 percent higher than Chinese wages and this disparity dampened growth in manufacturing. In 2010, however, that disparity fell to approximately 20% according to The Economist. Taken together with the cost of fuel, the competitive edge may be tipping back

²⁰ Banco de Mexico Annual Report 2010.

²¹ Jeff Tyler, "Mexico's job industry is growing stronger," Marketplace, January 5, 2011.

²² Jeff Tyler, "U.S. companies boos jobs in Juarez, Mexico," Marketplace, July 27, 2011.

in favor of Mexican manufacturing exports.²³ Gains in manufacturing employment in Mexico under NAFTA proved disappointing on the whole. Viewed against a backdrop of recessions and stiff Chinese competition, however, the modest gains produced are grounds for cautious optimism.

Employment trends in the agricultural sector under NAFTA differed substantially from those in manufacturing. Although agricultural trade, both imports and exports, increased steadily, employment in the sector appeared to suffer substantially from exposure to free trade. While Mexican agricultural exports to the United States more than doubled between 1994 and 2008, agricultural employment fell from 8.1 million to 5.8 million during the same timeframe. According to a Congressional Research Service report, domestic policy changes begun in the 1980s had a far greater impact on Mexican agricultural employment than free trade, but elimination of tariffs by NAFTA contributed to the steady erosion of jobs in the sector. The Mexican government anticipated these impacts and instituted a number of programs to ease the consequences of increased competition. Starting in 1993 the Program of Direct Support for the Countryside (PROCAMPO) provided direct income support to vulnerable farmers; *Alianza* began providing support to agricultural productivity improvements in 1995; *Produce Capitaliza* supported infrastructure development and livestock producers; in 2002 *Financiera Rural* began providing credit for equipment purchases.²⁴ These programs did not compensate for job losses, but they did substantially soften the impact of free trade on vulnerable farmers and facilitated steady increases in agricultural production and exports. Nevertheless, subsistence farmers in central and southern Mexico, among the nation's poorest and most vulnerable citizens, saw their

²³ The Economist, "Making the Desert Bloom," August 27, 2011, <http://www.economist.com/node/21526899/print>.

²⁴ Villarreal, 15.

livelihoods vanish when American corn, bean and rice imports drove down the value of their crops.²⁵ Although NAFTA facilitated increased trade in agricultural products, competition coupled with removal of protective measures contributed to declining employment in the sector.

Thus, NAFTA produced mixed results on employment in the manufacturing and agricultural sectors. While free trade and foreign direct investment created a modest number of factory jobs, especially in *maquiladora*-related industries, benefits were localized by the nature of the work. Both manufacturing and agricultural trade remained closely tied to economic conditions in the United States and suffered during recessions but unevenly. The decline in agricultural employment resulted from a number of factors, of which free trade was one. At best, NAFTA contributed to modest increases in Mexican formal employment since 1994. Since employment constitutes one of the chief factors affecting poverty rates, the trade agreement's impact on poverty was similarly modest. Nevertheless, the fact that its modest gains were achieved despite unfavorable circumstances holds out the promise of better results.

Poverty

Spikes in Mexico's poverty rates during the NAFTA years coincided with the peso crisis in 1995 and the global recession in 2008. In 1994, 51 percent of Mexicans lived in poverty, with 21 percent of those living in extreme poverty. By 1996, the effects of the crisis helped drive nearly 70 percent of the population into poverty, and more than half of those into extreme poverty. Poverty rates declined slowly but steadily starting in 1996 and reached approximately 45 percent poverty and 11 percent extreme poverty by 2008. A 2011 study by

²⁵ Zapeda, 12.

the National Political and Social Development Commission (CONEVAL) reported the poverty rate rose to 46 percent in 2010 although extreme poverty declined slightly.²⁶

While economic crises contributed to increased poverty, emigration, Mexican social programs, and free trade helped reduce it during the NAFTA period. Free trade's influence on employment had second order effects on poverty. Where it contributed to job creation it boosted prosperity; where it eroded employment it exacerbated poverty. State poverty rates reveal a significant geographic split which correlates to NAFTA-influenced employment trends. Gains in manufacturing employment primarily benefited northern states (which host the majority of *maquiladora* factories) and coincided with substantial increases in prosperity. Northern states averaged less than 10 percent extreme poverty in 2010.²⁷ On the other hand, many already poor states in central and southern Mexico bore the brunt of job losses in the agricultural sector, contributing to extreme poverty rates as high as 40 percent.²⁸ Although both sectors remained dependent to some extent on U.S. demand for exports, manufacturing proved the more vulnerable and affected northern states accordingly. Between 2008 and 2010, northern states recorded significant increases in poverty as demand for manufactured goods declined during the global recession. Employment suffered accordingly. Although poverty remained high in southern states during the same period, it remained largely stagnant.²⁹ Most likely southern states would have suffered proportionately from the recession, but social programs directed at the agricultural sector helped insulate them.

²⁶ Will Ollard, ed. Latin American Mexico & NAFTA Report, Latin American Newsletters, September 2011, 16.

²⁷ GeoMexico, "Is poverty in Mexico on the rise?" <http://www.geo-mexico.com/?p=5075>. (cites a 2010 CONEVAL report)

²⁸ Ibid.

²⁹ Ibid.

Additionally a poverty alleviation program called *Oportunidades* provided support to five million families, primarily in poor southern states.³⁰

NAFTA's effects on poverty may be traced through its effects on employment. At best it has been partially successful at boosting employment and thereby reducing poverty in northern states. In southern states, free trade in agricultural products contributed to significant job losses, but social programs and migration mitigated the corresponding effects on poverty.

Undocumented Migration

Some argue that NAFTA caused an explosion of undocumented migration from Mexico into the United States while others contend that the trade agreement exerted a minor influence on migration flows. This paper asserts that NAFTA's effect was positive, in that it contributed to increased employment and prosperity, but minor. According to the Congressional Research Service, approximately 1.67 million undocumented migrants arrived from Mexico between 1990 and 1994, 3 million arrived between 1995 and 1999, and nearly 3.2 million arrived between 2000 and 2004.³¹ Based on this data there was indeed a sharp spike in illegal immigration during NAFTA's first decade, but high levels of extreme poverty in the wake of the peso crisis contributed substantially. Because free trade contributed to declining employment, especially in the agricultural sector, it was also partially to blame.

Between 2005 and 2009, however, undocumented migration plummeted; according to the Pew Hispanic Center, less than one million crossed the border during this period.³²

Several major factors besides NAFTA may have contributed to the decline. Border security

³⁰ Villareal, p6

³¹ Ruth Ellen Wassem, "Unauthorized Aliens Residing in the United States: Estimates Since 1986," Congressional Research Service. September 22, 2011.

³² Jeffrey Passel & D'Vera Cohn, "US Unauthorized Immigration Flows Are Down Since Mid-Decade." Pew Research Center: Washington, 1 September 2010.

and immigration enforcement dramatically increased after September 11th, 2001 and could have exercised a deterrent effect. These efforts increasingly forced migrants away from California and Texas crossings into the deserts of Arizona. In addition to increasing the danger associated with crossing the border, this effectively raised the cost of coyote services.³³ It is likely this cost increase was responsible for some of the reduction in migrant flow. Among those who disagreed was Wayne Cornelius, Director of the Center for Comparative Immigration Studies at the University of California, San Diego. He found that enforcement efforts led migrants to change their strategies but failed to deter those driven north by desperation.³⁴ Unemployment in the United States is also credited with deterring migration, but *The Economist* found that Americans had little appetite for the farm labor performed by many migrants,³⁵ and the U.S. Chamber of Commerce argued that more immigrant workers are needed for seasonal agricultural work.³⁶ Economic conditions in the United States and immigration enforcement likely led some potential Mexican migrants to reconsider the journey north. Nevertheless, better conditions in Mexico indicate that fewer are desperate enough to attempt it.

Demographic statistics on undocumented migrants changed in ways which point to NAFTA's influence. Free trade reduced pressures to migrate in northern states by contributing to gains in employment and prosperity. In southern states, job losses and widespread poverty increased them. A Bi-National Migration Institute report released in

³³ Julia Preston, "Mexican Data Show Migration to U.S. in Decline," *New York Times*, 15 May 2009.

³⁴ Wayne A. Cornelius, "Impacts of Border Enforcement on Unauthorized Mexican Migration to the United States," Social Science Research Council, September 26, 2006.

³⁵ *The Economist*, "Fields of Tears," 397.8713, December 18, 2010.

³⁶ Steven A. Camarotta, "A Need for More Immigrant Workers?" Center for Immigration Studies: Washington, June 2011.

2007 found that undocumented migrants increasingly originate from southern states.³⁷

Remittance trends reported by the Congressional Budget Office corroborate this trend, indicating southerners make up an increasingly large proportion of undocumented migrants.³⁸ It is also significant to note that the total flow diminished significantly in the last half-decade. This suggests that conditions in Mexico have improved to the extent that significantly larger proportions of the Mexican population are no longer desperate.

Conclusions & Recommendations

Gary Hufbauer argues that trade agreements represent opportunities for economic development, but they must be carefully handled to produce desired results and minimize unintended consequences.³⁹ Free trade is a blunt instrument which, in cutting tariffs, also unleashes competition. As a result, though trade increases, the strong are likely to benefit while the weak suffer. Such has been the case with NAFTA and the Mexican economy: multinational corporations and the Mexican elite profited while many of the most vulnerable suffered.⁴⁰ Portions of the manufacturing and agricultural sectors flourished modestly in a free trade environment while others withered. Sluggish Mexican infrastructure development and corruption limited the potential of free trade to increase prosperity more generally.⁴¹

Ultimately, free trade is not to blame for Mexico's ills; most of them existed prior to NAFTA's implementation. Free trade did exacerbate some of them, but evidence suggests it helped ameliorate others. The peso crisis and the 2008 global recession profoundly influenced economic conditions in Mexico. Although NAFTA did not cause them, it

³⁷ University Communications, "UA Binational Migration Institute Releases Study on Unauthorized Border-Crossers Deaths," UA News, February 13, 2007.

³⁸ Congressional Budget Office, "Migrants' Remittances and Related Economic Flows," February, 2011.

³⁹ Gary Hufbauer and Jeffrey Schott, NAFTA Revisited, Peterson Institute for International Economics: Policy Options, October 2007.

⁴⁰ Norman Caulfield, NAFTA & Labor in North America, Urbana: University of Illinois Press, c2010, 41-42.

⁴¹ Deroy Murdock, Mexico's Government Failures Fuel Illegal Immigration. *Human Events*, Jun 26, 2006.

amplified the effects of the latter because it increased sensitivity to fluctuations in the U.S. economy. Nevertheless, trends indicate that NAFTA did contribute significantly to employment growth and poverty reduction, even if the precise impact in terms of numbers remains unclear. Accordingly, it should be credited with contributing to the sharp reduction in undocumented migration to the United States.

Attitudes toward NAFTA in Mexico are broadly favorable, except among poor agricultural workers.⁴² In the United States opinions remain sharply divided. In February 2011, Representative McIntyre (D-NC) argued for repealing the agreement, citing damage to American employment and manufacturing.⁴³ Many studies indicate that NAFTA's impacts on the United States have been minimal, and Congress recently approved new free trade agreements with South Korea, Columbia, and Panama, citing their potential to create American jobs.

The same is true of NAFTA, which also demonstrated its potential to boost Mexican employment and prosperity. It thereby reduced the desperate conditions which drive undocumented migration to the United States and threaten to destabilize a neighbor and major trading partner. Recent trends are encouraging and indicate recovery from the global recession, but continued improvement is far from guaranteed. The global economy remains fragile, and a relapse could wipe out gains to date. Drug cartel violence so far has failed to deter foreign investment in northern Mexican manufacturing, but threatens to do so should it escalate out of control.⁴⁴

⁴² Villarreal, 16.

⁴³ Federal Information & News, Inc. "McIntyre Says: We Need to Repeal NAFTA!" Congressional Documents and Publications, February 14, 2011.

⁴⁴ Jeff Tyler, "U.S. companies boost jobs in Juarez, Mexico," Marketplace: American Public Media, July 27, 2011.

The United States should continue to bolster Mexican efforts to rein in cartel violence in order to mitigate its effects on economic development. Mexican infrastructure development and corruption reduction should be encouraged in order to spread and deepen the benefits of free trade. Despite these risks and the modest results obtained to date, NAFTA possesses considerable potential: it should be reinforced rather than repealed. Although it will not solve Mexico's problems, it forms an essential component of any strategy to increase stability and prosperity south of the border.

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